

## **Oddball tax forms from your creditors, or don't throw those 1099s away!**

If you are having financial difficulties, you may receive either forms 1099-A or 1099-C from your creditors. If you receive a 1099-A or 1099-C and you are NOT in bankruptcy, these forms show **taxable** income unless you meet one of several exceptions. The care and reporting of these forms is important – you are having financial difficulties, you don't want to have the IRS on your case also!

Always check the information on these forms – the name of the institution, the account number, the amount of debt, and the value of the collateral reported on these forms. The bank or financial institution has minimal reason to get these items correct. Most critical are the amounts owed (forgiven) and the value of the collateral. There often will be significant differences between what you think you owe and the amounts reported. If you have such records to document your amount, you can reduce the taxable income from these forms that you report.

The value of the collateral is also important. If too high, you may miss the opportunity to exclude income from your return. If too low, you may transmute lower taxed capital gains to ordinary income.

If the 1099-C is from credit cards, this income is miscellaneous ordinary income. If the 1099-C is for debt secured by an asset (which was foreclosed on), report the income as the sale of an asset. If a personal asset, the gain is taxable and a loss non deductible. If a business asset, the gain is taxable and the loss is deductible. The sales proceeds equal the amount of the debt forgiven.

If you receive a 1099-A for secured debt, your reporting is more complicated. The 1099-A will have an amount for the value of the property securing the debt. For income tax purposes, the “sales price” is the lesser of the debt or the fair market value of the property.

If the debt is higher than the value of the property, (you were upside down on the property), you have a two step transaction – which may not be finished in the current year. First you have the reportable property sale. Second, you have potential debt forgiveness income -- if the creditor has given up collecting the debt. If the creditor is still trying to collect the debt, you do not have debt forgiveness income. You have to wait until they give up.

If you are foreclosed on and your debt is recourse, call your tax preparer. Recourse debt is debt where the lender can require you to pay any debt unpaid after the sale of the property. You may find it a good idea to see if your creditor will forgive the debt this year instead of a future year.

There are several ways that a taxpayer can exclude debt forgiveness income. First, any debt forgiveness income from bankruptcy is non taxable. Second, an insolvent taxpayer at the date of the debt forgiveness income can exclude debt forgiveness income to the extent

that the debt exceeds the fair value of the taxpayer's assets. This calculation is complex. Please consult with a tax preparer before claiming this exclusion. Third, up to \$1,000,000 of debt forgiveness of original debt that is on your principal residence can be excluded from income. This exception does not require bankruptcy or insolvency.

IRS Circular 230 requires us to include the following statements in all tax advice related correspondence. The information provided above is general information. Any tax advice contained in this communication (or in any attachment) represents our best judgment and is not intended or written to be used, and cannot be used, by you or any party for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed in this communication (or in any attachment). All parties should seek advice based on their own particular circumstances from their independent tax advisor. We will not update this essay for subsequent changes to the tax law, regulations or case law.